SUPREME COURT, U. S.

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In the
Supreme Court of the United States

October Term, 1968

No. [redacted] 140

GOOD-ALL ELECTRIC MFG. CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT (AND APPENDICES)

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT (AND APPENDICES)

Good-All Electric Mfg. Co. prays a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered herein (the judgment appears as Appendix A).

OPINIONS BELOW

The opinion of the Court of Appeals appears in 21

ATFR 2d 813 and appears as Appendix B. The decision of the Tax Court appears as Appendix C. The Memorandum Findings of Fact and Opinion of the Tax Court appear in Prentice-Hall Tax Court Memo Decisions 1965 at paragraph 65,154, and appears as Appendix D. Several other cases were consolidated for trial with the case at bar and the portions of the lower courts' opinions dealing with those cases have been omitted from Appendices B and D.

JURISDICTION

Judgment of the Court of Appeals was dated and entered on March 5, 1968. Jurisdiction of this Court is invoked under section 1254(1) of Title 28 of the United States Code. The decision of the Tax Court of the United States was entered on July 26, 1966, and petition for review and bond were filed on October 25, 1966. The purported notice of deficiency was mailed on September 27, 1961, and petitioner filed its petition in the Tax Court of the United States on December 26, 1961.

QUESTIONS PRESENTED

1. Has the Tax Court performed its fact finding functions and can its decision stand when it makes an ultimate holding that petitioner accumulated its earnings and profits beyond the reasonable needs of the business (1) without finding what earnings and profits were accumulated, (2) without finding what were the reasonable

needs of the business, and (3) without determining whether renegotiation liabilities owed to the United States government in the total net amount of $978,557.35 and additional federal taxes totaling $245,868.31 must be provided for in determining "earnings or profits," particularly where the renegotiation and additional tax liabilities would eliminate any possibility of accumulation beyond the reasonable needs of the business?

2. In determining petitioner's earnings and profits for purposes of section 102 of the Internal Revenue Code of 1939, must reduction be made for amounts which petitioner is required to pay to the United States under the Renegotiation Act of 1951 and contracts entered into pursuant thereto and for income and excess profits taxes owed to the United States under the tax laws?

3. Are the federal income taxes which are allowed as a deduction under section 102(d)(1)(A) of the Internal Revenue Code of 1939 computed by disregarding items of income not included in the petitioner's tax return, but by giving effect to renegotiation liabilities (and thereby further reducing the deduction for taxes) even though the renegotiation liabilities were also not deducted in the tax return?

4. Has the Commissioner made a determination within the meaning of section 272(a) of the Internal Revenue Code of 1939 when he has deliberately refrained from deciding major issues that are in controversy?

STATUTES INVOLVED

The case involves the following statutes:

Internal Revenue Code of 1939, section 102(a):

"§ 102. Surtax on corporations improperly accumulating surplus

"(a) Imposition of tax. There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

"27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

"38½ per centum of the undistributed section 102 net income in excess of $100,000."

Internal Revenue Code of 1939, section 102(d)(1)(A):

"(d) Definitions. As used in this chapter—

"(1) Section 102 net income. The term 'section 102 net income' means the net income, computed without the benefit of the capital loss carry-over provided in section 117(e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23(s), minus the sum of—

"(A) Taxes. Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Sub-

chapter E of Chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law."

Internal Revenue Code of 1939, section 57:

"§ 57. Examination of return and determination of tax

"As soon as practicable after the return is filed the Commissioner shall examine it and shall determine the correct amount of the tax."

Internal Revenue Code of 1939, section 272(a):

"§ 272. Procedure in general

"[(a)(1) Petition to The Tax Court of the United States.] If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. * * *."

* * *

Internal Revenue Code of 1954, section 7459(b):

"(b) Inclusion of Findings of Fact or Opinions in Report—It shall be the duty of the Tax Court and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Tax Court shall report in writing all its findings of fact, opinions, and memorandum opinions."

STATEMENT OF THE CASE

The Commissioner stated in the notice of deficiency that petitioner had been availed of for the purpose of preventing the imposition of surtax on its shareholders:

> "* * * through the medium of permitting its earnings or profits * * * to accumulate beyond the reasonable needs of its business * * *." (Exhibit A of Petition).

Since a statement was filed under section 534(c) of the Internal Revenue Code of 1954, the Tax Court and the Court of Appeals assumed that the Commissioner had the burden of proving that the earnings were accumulated beyond the reasonable needs of the business (Appendix B, p. 43).

The Tax Court, without determining what earnings or profits had been accumulated, without deciding whether amounts owed to the United States under the Renegotiation Act of 1951 and under the federal tax laws must be considered in determining earnings and profits, and without determining what were the business needs of the corporation, made the conclusory holding that the earnings and profits were accumulated beyond the reasonable needs of the business. This holding was affirmed by the Court of Appeals.

The first five years of the petitioner's operations are involved and, consequently, all of its earnings and profits were before the Tax Court. Based upon the Tax Court's decision, petitioner's earnings and profits (assuming all of its renegotiation liabilities and federal taxes for the

years involved reduce earnings and profits) were as follows:

Earnings and Profits

	1950	1951	1952	1953	1954
1. Taxable income (Resp. Rule 50 Comp.)	$382,022.99	$594,406.38	$982,247.07	$1,210,644.01	$2,070,892.48
2. Less taxes on income (T. C. decision)	233,939.13	463,722.10	803,807.58	1,060,157.89	1,579,590.83
3. Less interest on tax deficiencies (computed		5,271.46	17,312.67	28,019.51	51,218.75
4. Earnings before dividends	$148,083.86	$125,412.82	$161,126.82	$ 122,466.61	$ 440,082.90
5. Less dividends (II Stip., ¶ 18; III Stip., ¶ 20b)	2,000.00	10,075.10	22,699.27	6,432.37	2,250.00
6. Earnings and profits	$146,083.86	$115,337.72	$138,427.55	$ 116,034.24	$ 437,832.90

Some of petitioner's major capital needs were as follows:

Fiscal Years Ending May 31:

Capital Needs	1950	1951	1952	1953	1954
1. Items capitalized in current year (II Stip., ¶ 17, 22, 23, 24)	$ 14,752	$ 12,252	$ 21,070	$ 74,360	$ 73,423
2. Items capitalized in prior years (Line 1)		14,752	27,004	48,074	122,434
3. Accounts receivable (Exs. 1-A to 5-E)	69,728	468,667	530,117	531,827	685,854
4. Inventory per tax returns	36,195	84,873	80,629	76,598	297,395
Adjustment (Ex. A of Pet.)	14,532	63,145	46,206	124,502	(248,387)
5. Fixed assets (Ex. 5-E)					112,813
6. Renegotiation for current year (Stip. II, ¶ 20)		56,632	360,000	150,012	411,912
7. Renegotiation for prior years (unpaid)			56,632	416,632	566,644
8. Tax deficiencies for current year (Resp. Rule 50)	22,289	98,663	44,591	226,649	(146,325)
9. Tax deficiencies for prior years (unpaid)		22,289	120,952	165,543	392,192
10. 1954 Tax due (T. C. decision)					1,579,590
11. Total of above needs	$ 157,496	$821,273	$1,287,201	$1,814,197	$3,847,545
12. Less original capital and paid in surplus	500,000	500,000	500,000	500,000	500,000
13. Additional needs	$(342,504)	$321,273	$787,201	$1,314,197	$3,347,545

The above schedule makes no allowance for labor, rent, local taxes, utilities, insurance, repairs, supplies, overhead or any other such costs.

The relationship between accumulated earnings and profits (assuming all federal renegotiation and tax liabilities are deductible in arriving at earnings and profits) and the capital needs set out in the above schedule is as follows:

	Fiscal Years Ending May 31:				
	1950	1951	1952	1953	1954
Earnings and profits					
Current year	$ 146,083	$115,337	$138,427	$116,034	$ 437,832
Prior years		146,083	261,420	399,847	515,881
Total	$ 146,083	$261,420	$399,847	$515,881	$ 953,713
Capital needs in excess of orig. capital	(342,504)	321,273	787,201	1,314,197	3,347,545
Excess of capital needs	$(488,587)	$ 59,853	$387,354	$798,316	$2,393,832

With respect to the computation of the section 102 surtax, the Tax Court first ruled that there should be deducted under section 102(d)(1)(A) "* * * only those taxes shown on the original returns." (Order of June 20, 1966) The Commissioner submitted a computation which allowed as a deduction neither the tax as shown on the original returns nor the taxes as finally determined by the Tax Court. Respondent's computation included in income, for this purpose, only the income shown on the original returns. He showed as a deduction, however, the renegotiation liabilities which were not shown on the original returns, thereby reducing very substantially the tax deduction under section 102(d)(1)(A) (Resp. comp. for entry of decision).

Petitioner filed a supplemental computation for entry of decision under Rule 50 which, in accordance with the Tax Court's holding of June 20, 1966, showed as a deduction the amount shown on the original return. The Tax Court, however, entered its decision in accordance with the respondent's computation. The Court of Appeals affirmed this computation on the ground that the additional taxes were "contested in this litigation" and could not, therefore, be deducted (Appendix B, pp. 54, 55). Most of the additional items of income which were excluded from the tax computation because they were "contested in this litigation" were not in fact so contested. Exhibit A of the notice of deficiency (which is itself Exhibit A of the petition filed in the Tax Court) shows a list of items which are designated:

> "Adjustments for Unallowable Deductions and Additional Income not Protested."

The totals of these amounts by year were:

Fiscal years ending May 31:

1950	$ 51,230.52
1951	159,338.63
1952	166,125.73
1953	278,293.53
1954	78,701.72

The only items of income or unallowable deductions which were contested and which entered into petitioner's actual tax liability as found by the Tax Court were:

	Fiscal Years Ending May 31:				
	1950	1951	1952	1953	1954
Capital expenditures	$ 9,752.87	$12,252.40	$21,070.39	$70,678.47	$22,864.06
Salaries	2,000.00	5,000.00	5,000.00	5,000.00	2,250.00
Travel				844.48	
New buildings				3,682.12	50,559.02
	$11,752.87	$17,252.40	$26,070.39	$80,205.07	$75,673.08

The amounts of the renegotiation liabilities, which the Tax Court used to further reduce the tax deduction, were determined by the Regional and National Renegotiation Boards (Tr. 72-103). Appeals were taken from the Regional Renegotiation Board to the National Board with respect to 1953 and 1954 (Tr. 98).

The following facts bear on the issue of whether the Commissioner made a determination: (1) The Commissioner "determined" that the corporation distributed in excess of $2,000,000 to the partnership as dividends (Appendix D, p. 68) and, at the same time, that the corporation distributed no dividends (Ex. A of Pet.; ¶ 9(v) of Ans.); (2) the Commissioner "determined" that payments under the Rental and Manufacturing Agreement were excessive in the amount of $994,797.60 (Ex. A of Pet.), "determined" these excess amounts were dividends to the partnership (Appendix D, p. 68), but at the same time "determined" that the corporation distributed no dividends (Ex. A of Pet.; ¶ 9(v) of Ans.).

REASONS FOR GRANTING THE WRIT

The questions presented in this petition are of prime importance in the administration of the tax law, particu-

larly the accumulated earnings tax, and are questions that should be settled by this Court. In addition, the decisions of the Tax Court and the Court of Appeals on some of the questions are in conflict with the decisions of the other Courts of Appeal and, in one instance, reflect an improper application of the decisions of this Court. The reasons for granting the writ are hereinafter set forth specifically with respect to each question.

Question No. 1

The application of the heavy penalty imposed by the accumulated earnings tax is generally dependent upon findings of fact with respect to (1) the amount of earnings and profits accumulated, (2) the business needs of the corporation and (3) the purpose which prompted the accumulation. Unless we make the requirements for the determination of these facts clear, strict and demanding, this severe penalty provision of the law can become a monster which, at the whim of a trial court, can determine the future or even continued existence of any corporation. This Court has recognized the importance of establishing clearly the rules for the determination of the third fact, "purpose", by granting a writ of certiorari in *United States v. Donruss Company,* 88 S. Ct. 1406. It has been recognized that "* * * in the normal case a determination that accumulations were not unreasonable in the light of the needs of the business amounts to a finding favorable to the taxpayer on the most persuasive fact which would show that the corporation was not availed of for the purpose of preventing the imposition of a surtax upon its shareholders * * *." *R. Gsell & Co. v. Commissioner,* 294

F. 2d 321, 327, C. A. 2, 1961. Likewise, "* * * the two issues are largely interdependent * * *." *Electric Regulator Corp. v. Commissioner,* 336 F. 2d 339, 345, C. A. 2, 1964. Consequently, it is even more important in the administration of the law that the rules for determining the amount of accumulated earnings and business needs be clarified. This is particularly true in view of the recognition that "Comments made in the past * * * may have to be appropriately qualified in particular cases." *Electric Regulator Corp. v. Commissioner,* 336 F. 2d 339 at page 346, C. A. 2, 1964.

The Court of Appeals in this case permitted the Tax Court to hold that the corporation had accumulated its earnings and profits beyond the reasonable needs of the business without finding (1) what earnings or profits were accumulated, (2) what were the needs of the business and (3) whether renegotiation and additional tax liabilities reduced earnings and profits. This holding was made notwithstanding the fact that the renegotiation liabilities themselves, if given consideration, would have eliminated any possibility of excess accumulations.

Such a holding permits the imposition of a heavy penalty tax on the basis of a "feeling" or intuition and violates the requirements of section 7459 of the Internal Revenue Code of 1954 that the Tax Court decisions shall be "* * * in accordance with the report of the Tax Court" and that this report shall include "its findings of fact."

The Court of Appeals' decision in this case is also in conflict with the holding of the Court of Appeals for the

Seventh Circuit in *Wisconsin Memorial Park Company v. Commissioner*, 255 F. 2d 751, 752, C. A. 7, 1958, to the effect that:

> "* * * Thus the Tax Court is required to do more than pronounce a conclusion since it must lay bare for judicial review as well as for the parties—the basis of its decision. We, on the other hand, can then examine the factual explanation given by the Tax Court for its ultimate conclusion reached by relating its analysis of the evidence to the statutory standard prescribed by the Code. * * *"

The decision of the Court of Appeals is also in conflict with the decisions of this Court with respect to the duties of the fact finder as set out in *Duberstein v. Commissioner*, 363 U. S. 278; *United States v. Merz*, 376 U. S. 192; *Burlington Truck Lines v. United States*, 371 U. S. 156; and similar cases. The decision exemplifies the warning quoted in *Burlington Truck Lines v. United States*, supra, at page 167:

> "* * * Unless we make the requirements for administrative action strict and demanding, *expertise*, the strength of modern government, can become a monster which rules with no practical limits on its discretion."

At page 44 of Appendix B, the Court of Appeals justifies the holding on the ground that the Tax Court did find (1) what "the corporation's records showed as to earned surplus and undivided profits" at the end of each of the five fiscal years, (2) "the cash account on the same dates", and (3) "inactivity as to the cash."

Neither the Commissioner, the Tax Court nor the Court of Appeals, however, found that what petitioner's

records "showed" as to surplus and profits constituted the "earnings or profits." In fact, the Commissioner made and the Tax Court and the Court of Appeals upheld large adjustments in income, renegotiation liabilities and even assets, all of which materially changed what the books "showed". Moreover, as respondent's counsel pointed out to the Tax Court, "* * * the books are in very poor shape. This is the reason the negligence penalty was asserted * * *" (R. 43).

In addition, the Court's holding on this point is in conflict with the following conclusion of the Court of Appeals for the Second Circuit in *Electric Regulator Corp. v. Commissioner,* 336 F. 2d 339, at page 344:

> "Again, it is apparent that balance sheet totals rarely, if ever, tell the whole story."

The amount of cash is, of course, meaningless unless related to cash needs. The highest amount of cash was at May 31, 1954, in the amount of $3,198,585.98 (Appendix B, p. 48). But as the Court of Appeals acknowledged, $2,124,327.81 was needed just to pay the tax shown on the 1954 return (Appendix B, p. 50) and, as pointed out in the statement of the case above, there were unpaid renegotiation liabilities of $978,556 and unpaid additional tax liabilities of $245,867 without including interest, and many other needs for this cash in the business. Consequently, this finding could not possibly justify the Tax Court's decision.

The holding is also directly in conflict with the following holding in *Electric Regulator Corp. v. Commissioner,* 336 F. 2d 339, C. A. 2, 1964, at page 344:

> "* * * Only after close analysis of the nature of the cash account and the present and anticipated demands which it will be forced to meet, can a trier of fact venture a finding that the liquid assets justify the declaration of a dividend. Nothing in the Internal Revenue Code prohibits large cash balances where the taxpayer has sufficient need for the cash in its business. * * *"

The only other factor referred to by the Court was the "inactivity" of the cash. But "inactivity" is not equivalent to lack of need. And, as the Court in *Electric Regulator Corp. v. Commissioner,* supra, pointed out, only after a close analysis of these needs can "* * * the trier of fact venture a finding that liquid assets justify the declaration of a dividend."

Question No. 2

The determination of the second question is absolutely essential to the administration of the accumulated earnings tax. If, as the lower courts appear to have held, amounts which a corporation is required by law and by contract to pay to the United States government are included in their earnings and profits, these corporations face an absolute bar to growth and face certain financial ruin. Under such a holding, the more a corporation owes the United States in renegotiation and tax liabilities, the greater would be its earnings and profits and the more certain would be the imposition of the accumulated earnings tax. Such a holding would be a patent perversion of the statute.

It is not clear whether the lower courts have held that renegotiation and additional tax liabilities do not

reduce earnings and profits or whether they have simply ignored these liabilities in determining (or failing to determine) earnings and profits. At pages 44 and 45 of Appendix B, the Court of Appeals states the corporation's argument to be that actual renegotiation and tax liabilities enter into the determination of "section 102 net income" and unlimited accumulation can occur as long as the possibility of further tax or renegotiation liability exists. No such contentions were ever made.

Our contention has at all times been that actual tax and renegotiation liabilities reduce earnings and profits and that we have to find what the earnings and profits are and compare them with the business needs.

At pages 47 to 49 of Appendix B, the Court of Appeals appears to have held that these liabilities can be ignored because their amounts were determined in later years. Such a holding is in conflict with the following authorities:

I. T. 3688, Cumulative Bulletin 1944, p. 401.

Jerome E. Casey, Prentice-Hall Memo T. C., ¶ 57,226.

W. S. Farish & Co., 38 B. T. A. 150, *affirmed* 104 F. 2d 833, C. C. A. 5, 1939.

Drybrough v. Commissioner, 238 F. 2d 735, C. A. 6, 1956.

Demmon v. Commissioner, 321 F. 2d 203, C. A. 7, 1963.

Revenue Ruling 57-332, Cumulative Bulletin 1957-2, p. 231.

As the Treasury itself ruled in I. T. 3688, at page 402:

> "In the case of a corporation which files its Federal income and excess profits tax returns on the accrual basis for the calendar year, it is held, in view of the provisions of section 3806 of the Code, that an amount of profits accrued in any taxable year, determined to be excessive under renegotiation and required to be paid to the United States, withheld, or applied as an offset against other amounts due the taxpayer, should be treated as a reduction of the earnings and profits *for such year of accrual.* Thus, in the instant case, the amount of the excessive profits of 10x dollars determined for the year 1942 should be eliminated from accumulated earnings and profits as of *December 31, 1942,* which enter into invested capital for the calendar year 1943." (Italics supplied.)

In Revenue Ruling 57-332, Cumulative Bulletin 1957-2, at page 232, the Treasury ruled that neither later determination nor contest of a liability postpones its accrual for purposes of determining earnings and profits. The concluding paragraph of the ruling is as follows:

> "In view of the above, the Internal Revenue Service now holds that in determining the amount of corporate earnings and profits available for dividends, each fraud addition to a deficiency for which an accrual method corporation is held liable must be deducted from the earnings and profits of such corporation in the year that it filed the return to which the fraud addition applies, even though such penalty is contested."

Question No. 3

The Tax Court refused to allow a deduction under section 102(d) (1) (A) for the corporation's actual federal income and excess profits taxes. The Tax Court ruled that only the tax shown on the original return could be deducted, but then, without explanation, adopted respondent's Rule 50 computation which further reduced the deduction because of the later-determined renegotiation liabilities. The Court of Appeals affirmed.

The refusal to allow a deduction of the actual tax liabilities conflicts with the decisions in *Drybrough v. Commissioner*, 238 F. 2d 735, C. A. 6, 1956; *Demmon v. Commissioner*, 321 F. 2d 203, C. A. 7, 1963; *Commissioner v. Clarion Oil Co.*, 148 F. 2d 671, C. A. D. C., 1945, cert. den. 65 S. Ct. 1580; *Birmingham v. Loetscher Co.*, 188 F. 2d 78, C. A. 8, 1951; and *Harry M. Stevens, Inc. v. Johnson*, 115 F. Supp. 310, D. C. S. D. N. Y. 1953.

The courts in *Drybrough v. Commissioner* and *Demmon v. Commissioner*, supra, held that tax deficiencies and penalties, imposed after aggressive contest, were taxes "paid or accrued during the taxable year" to which the deficiencies related. In *Commissioner v. Clarion Oil Co.*, supra, the rule is stated as follows at page 675:

> "* * * And we think there can be no manner of doubt that taxpayer's income for the taxable year 1937 'accrued' in that year."

The Court of Appeals relied upon *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516, 1944. That decision applied to items of income and deductions in com-

puting net income. It is not applicable under section 102 (d) (1) (A). That section clearly intends to give a deduction for the actual tax liability for the taxable year and not for any tentative tax, partially recumputed tax or amount of tax shown on the original return. As the Court pointed out in *Commissioner v. Clarion Oil Co.*, supra, at pages 675 and 676:

> "* * * In other words, having determined 'net income' in accordance with the accounting methods of the taxpayer, there is no need to consider whether an ordinary income tax was 'paid' or whether it was 'accrued', since in either event it was a deductible item and no longer represented *accumulations* of income, which it was the intent of this tax to force out of the 'incorporated pocketbook' and into the hands of individual taxpayers."

Practical considerations in computing net income on an annual basis dictate the rule announced in *Dixie Pine Products Co. v. Commissioner*, supra. Deductions for items in litigation which might never be paid would create substantial administrative problems. These considerations are not present, however, in determining the deduction for income and excess profits taxes under section 102 (d) (1) (A). The income and excessive profits tax liabilities will, as was true in the case at bar, be determined at the very same time and in the very same proceeding as the accumulated earnings tax. It would indeed be a strange and artificial result to hold that even though these amounts are known at the very time the accumulated earnings tax is determined, a deduction could be had only for some lesser amount.

The Treasury itself recognizes that federal income taxes accrue notwithstanding contest. Thus Revenue Ruling 57-332, Cumulative Bulletin 1957-2, page 231, at page 232, declares:

> "In view of the above, the Internal Revenue Service now holds that in determining the amount of corporate earnings and profits available for dividends, each fraud addition to a deficiency for which an accrual method corporation is held liable must be deducted from the earnings and profits of such corporation in the year that it filed the return to which the fraud addition applies, even though such penalty is contested."

Consequently, the rule enunciated in the case at bar conflicts not only with the decisions of other Courts of Appeal but also with the announced position of the Treasury.

There does not appear to be either a logical or legal basis for the computation actually made by the Tax Court and approved by the Court of Appeals. That computation started with the tax shown on the return, reduced it on account of renegotiation liabilities which were not shown on the return and which were determined only after prolonged negotiation and hearing, but did not increase the deduction on account of additional income added by the Commissioner even though most of this additional income was not contested. If the actual tax liability is not deductible, the only reasonable alternative is the amount of tax shown on the tax returns.

Question No. 4

The fourth question raises a basic issue as to the function of the Commissioner of Internal Revenue: Is his function an administrative one, that of resolving issues affecting tax liability and the determination of the correct amount of the tax, or is his function that of a litigant who raises issues for the Courts to decide?

The holding of the Court of Appeals that the Commissioner need not make a decision where there is "acceptable legal theory" (Appendix B, p. 31) for more than one "approach" would apply to any genuine issue and would leave the Commissioner without any decision-making duties. This holding appears to be directly contrary to section 57 of the Internal Revenue Code of 1939 which requires that the Commissioner "* * * shall determine the correct amount of the tax" and to section 272(a) of that Code which permits the issuance of a notice of deficiency only if "* * * the Commissioner determines that there is a deficiency * * *." From the inception of the Board of Tax Appeals, it has been held that the Board and the Courts enter the tax picture only after the Commissioner has made a determination and that this determination means:

> "* * * the final decision by which the controversy as to the deficiency is settled and terminated, and by which a final conclusion is reached relative thereto

and the extent and measure of the deficiency defined. * * *" *Terminal Wine Co.*, 1 B. T. A. 697, 701.

The same holding was made in *Lafayette Worsted Co. v. Page*, 6 F. 2d 399, D. C. R. I., 1925, and *James Couzens*, 11 B. T. A. 1040 at pages 1159 and 1160.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JAMES J. FITZGERALD, JR.,

JAMES W. R. BROWN,

LYLE E. STROM,

Counsel for Petitioner.

Dated: May —, 1968.

APPENDIX A

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 18,636. September Term, 1967

ON PETITION TO REVIEW DECISION OF THE TAX COURT OF THE UNITED STATES

GOOD-ALL ELECTRIC MFG. CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

This cause came on to be heard on the Petition to review the Decision of the Tax Court of the United States (Docket No. 95458), entered on July 26, 1966, determining that there are deficiencies in the income taxes of petitioner for the taxable years 1950 to 1954, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Decision of the said Tax Court in this cause be, and the same is hereby, vacated.

And it is further Ordered and Adjudged by this Court that this cause be, and it is hereby, remanded to the Tax Court of the United States for redetermination in order that the undistributed Section 102 net income shall be computed with the basic surtax credit including the excessive salary and unrecorded withdrawals to which Part VIB of the Opinion of this Court filed hereinerelates.

March 5, 1968.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 18,631

Estate of Robert A. Goodall, Deceased, C. M. Goodall, Executrix, Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

No. 18,632

Estate of Robert A. Goodall, Deceased, Clarice M. Goodall, Executrix,

Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

No. 18,633

Estate of Robert A. Goodall, Deceased, Clarice M. Goodall, Executrix, and Clarice M. Goodall, Petitioners,

v.

Commissioner of Internal Revenue, Respondent.

On Petitions for Review of Decisions of the Tax Court of the United States.

No. 18,634

Estate of Robert A. Goodall, Deceased, Clarice M. Goodall, Executrix,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

No. 18,635

C. M. Goodall,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

No. 18,636

Good-All Electric Mfg. Co.,
Petitioner,
v.
Commissioner of Internal Revenue,
Respondent.

On Petitions for Review of Decisions of the Tax Court of the United States.

[March 5, 1968.]

Before VOGEL, Senior Circuit Judge, and BLACKMUN and HEANEY, Circuit Judges.

BLACKMUN, Circuit Judge.

Robert A. Goodall died October 22, 1953.

The Commissioner of Internal Revenue, by his several 90-day letters, proposed deficiencies and additions[1] to tax as follows:

* * *

Good-All Electric Mfg. Co. (Our No. 18,636; Tax Court No. 95,458)	Corporation income tax for the fiscal years ended May 31, 1950/54, inclusive; § 102 surtax for all 5 years.

* * *

The Tax Court consolidated the several cases for hearing. Its detailed findings and opinion (Judge Mulroney) filed June 4, 1965 (not reviewed by the full court), T. C. Memo 1965-154, 24 T. C. M. 807, and its subsequent computational decisions under its Rule 50, filed July 26, 1966, redetermined deficiencies in the substantially reduced total net amount[2] of $2,214,677.63, and additions aggregating $146,489.65. The respective taxpayers petition for review of certain aspects of these redeterminations. Our jurisdiction is established.

The facts, as found by the Tax Court, are based on stipulations, oral testimony, a deposition, and many ex-

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1 Section 291 (a) of the 1939 Code and § 6651 (a) of the 1954 Code impose an addition to tax for failure to make and file a return. Section 293(a) imposes an addition for a deficiency due to negligence or intentional disregard of rules and regulations but without intent to defraud. Section 294 (d) (1) (A) imposes an addition for failure to make and file a timely declaration of estimated tax. Section 291 (d) (1) (B) imposes an addition for failure to make a timely payment of an instalment of estimated tax. Section 294(d)(2) imposes an addition for a substantial underestimate of estimated tax.

2 Overpayments were redetermined for Mrs. Goodall for 1958 and 1959.

hibits, some jointly stipulated or jointly introduced. The factual material is, of course, intricate and complex. We mention initially only a few background facts. Others are referred to as we consider the respective issues.

The decedent, Robert A. Goodall, and his wife, Clarice M. Goodall, were equal business partners under an agreement executed by them on December 10, 1916, shortly after their marriage. This partnership continued from that date until Mr. Goodall's death on October 22, 1953. Prior to May 28, 1949, the partnership operated an electronics business in Ogallala, Nebraska. It manufactured and sold capacitors, rectifiers, soldering machines, watch cleaning machines, and fishing reels. The capacitators were for proximity fuses for the United States Navy; the partnership had been approved by the Department of the Navy as an authorized supplier.

In 1940 the Goodalls organized a Nebraska corporation under the name of Ogallala Industries, Inc. It was inactive, however, and its charter lapsed in 1944. The Goodalls revived the corporation in 1947. In April 1949 its name was changed to Good-All Electric Mfg. Co. This is the taxpayer in our No. 18,636. It is hereinafter referred to as the corporation.

On May 28, 1949, the partnership and the corporation executed a Manufacturing and Rental Agreement under which the corporation on June 1 took over the manufacturing business theretofore conducted by the partnership.

The issues before us are:

I. The existence of Tax Court jurisdiction in the face of the taxpayers' claim that the Commissioner failed to

make the statutorily required determinations of deficiencies. This issue arises in all six cases.

* * *

V. The sufficiency of the evidence to support the Tax Court's finding that the corporation, in each of its fiscal years 1950/54, inclusive, permitted its earnings and profits to accumulate beyond the reasonable needs of its business, within the meaning of § 102(c) of the 1939 Code.

VI. The sufficiency of the evidence to support the Tax Court's finding that in those years the corporation was availed of for the purpose of preventing the imposition of surtax upon its shareholders, within the meaning of § 102(a).

* * *

We consider these issues in the order listed. Before we do so, however, we think it well to list certain matters which are not at issue on these petitions for review:

* * *

4. Not at issue are the corporation's deductions in fiscal 1950/54 of amounts accruing to the partnership under the manufacturing and rental agreement. The Commissioner disallowed the major portion of these on the ground that they were not ordinary and necessary business expenses under § 23(a) (1) (A) and thus were equivalent to dividends. The Tax Court, however, held that the amounts were deductible in their entirety. The Commissioner has not petitioned for review of this ruling which is adverse to him.

5. Not at issue is the character of the substantial withdrawals made by the partners from the corporation. The Commissioner determined that these withdrawals were not loans, as the partners claimed, but were taxable dividends. The Tax Court concluded that they were loans and thus were not includable in partnership gross income. Here, too, the Commissioner has not petitioned for review of this ruling which is adverse to him.

I. The jurisdictional issue. Did the Commissioner fail to make the deficiency determinations required for Tax Court jurisdiction?

The argument here advanced by the respective taxpayers[3] is that, in the administration of the federal income and estate taxes, self-assessment is basic; that the Commissioner, when a return is filed, is required, under §§ 57 and 840 of the 1939 Code,[4] to determine the correct tax; that only if he determines that the correct tax exceeds the returned amount is he authorized to issue a notice of deficiency; that the process of determination requires that he resolve all issues, citing Terminal Wine Co., 1 B. T. A. 697, 701 (1925); that notice of the deficiency so determined is a prerequisite for Tax Court jurisdiction under § 272 (a) (1) [and § 871 (a) (1)] of the 1939 Code and §§ 6212 (a) and 6213 (a) of the 1954 Code; that, in order to constitute a determination, the Commissioner's action must be "thoughtful and considered" and bona fide and not "a mere formal demand for an arbitrary amount

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3 We place to one side the fact that the taxpayers, who originally invoked the jurisdiction of the Tax Court, are now the ones attacking that jurisdiction on grounds not going to subject matter.

4 These sections have no counterpart in the 1954 Code.

as to which there were substantial doubt''; that only when there has been appropriate administrative action of this kind do the courts become involved; that in the estate tax case the Commissioner expressly acknowledged that he had not determined the deduction [in any amount in excess of $234,444.81] for income tax claims against the decedent [inasmuch as they were then being contested, beyond that figure, by the estate]; that there was no reason why he could not make a decision with respect to those claims; that he had taken inconsistent positions within and among the several cases; that this is so with respect to valuations, basis, an option choice, and the interpretation of certain transactions; that it is not a situation where several taxpayers were taking different positions on the same issues; that, indeed, the sole party in interest in all the cases (except the corporation) is Mrs. Goodall; that she and the corporation have not taken any inconsistent position; that the Commissioner's inconsistency is unconditional and not in the alternative; and that this has compelled the taxpayers to go to the Tax Court in order to avoid assessment.

The Tax Court refused to hold that the Commissioner was acting capriciously or arbitrarily. It observed that it was clear that the determinations, although inconsistent, were made in the alternative and that ''once a holding is reached on an issue it will be applied consistently where more than one taxpayer is involved''.

We decide this jurisdictional issue against the taxpayer and do so for a number of reasons:

1. The provisions in § 272 (a) (1) of the 1939 Code

and § 6212 (a) of the 1954 Code as to the determination of a deficiency do not specify that the determination be one which is fully consistent with every other determination made contemporaneously against a related taxpayer. Where there is no charge or indication of bad faith on the part of the Commissioner we are not disposed to read into the statute any such additional requirement for across-the-board legal theory consistency.

2. We see nothing inherently evil in the Commissioner's making inconsistent determinations as between taxpayers where, as here, there is acceptable legal theory for each approach and where the determination falls short of the frivolous or the unfair.

3. We perceive no element of genuine prejudice to the taxpayers despite their comment that, had the Commissioner acted otherwise, "these cases would have been resolved many years ago without the necessity of involving the courts". On the other hand, to compel the Commissioner to choose between good faith alternatives at the risk of later confrontation with the barrier of the statute of limitations, if his choice has been litigated and has not prevailed, could entail grave prejudice for the revenues and could result in a windfall to a taxpayer by way of escape from a just obligation otherwise due and collectible.

4. These are, after all, tax cases. Substantial sums are involved. The Commissioner is charged with the protection of the revenues. While these factors might be viewed as pragmatic, it would be unseemly, we feel, to force the Commissioner, in the performance of his ad-

ministrative duties, to make an awesome choice of this kind at his peril. Taxes are not a game. Of course, the Commissioner, and the government itself, in this court is no more and no less than just another litigant. But we are aware of every person's tax responsibilities and we are not inclined to let the realization of revenues stand or fall on so technical a base as impeccable consistency. Consistency is desirable but its virtue has limits. Good faith inconsistency buttressed by acceptable argument, when considered in the framework of the Commissioner's responsibilities, cannot be regarded as an offense which provides a bar to bona fide tax litigation.

5. Inconsistency in determinations, when they are not made in bad faith, does not equate with an absence of the statutorily required determination, as the taxpayers suggest. Each taxpayer, even though there are several related ones, by the determination and notice made for him, knows the position the Commissioner is taking with respect to his tax situation. So long as the ultimate resolution of the issues is consistent for all, we see no legal wrong.

6. We are not contrarily persuaded by the taxpayers' argument that Mrs. Goodall is the sole party in interest, other than the corporation, because she is the surviving spouse, is the survivor of the husband-wife partnership, is the sole executor of her husband's will, and is the sole beneficiary of his estate, and that, therefore, the inconsistencies here exist with respect to the same taxpayer. The decedent, the estate, Mrs. Goodall, and the partnership are all distinct in tax law, either as separate tax-

paying entities or, in the case of the partnership, as an information reporting entity. This separateness has tax significance and, after all, the method of filing returns, the doing of business in the partnership form, and the disposition of Mr. Goodall's estate, are products of considered choice by the taxpayers or one or more of them.

7. The Ninth Circuit has touched upon this jurisdictional issue in two cases. *Revell, Inc. v. Riddell,* 273 F. 2d 649, 658-60 (9 Cir. 1959), cert. denied 364 U. S. 835; *Malat v. Commissioner,* 302 F. 2d 700, 704 (9 Cir. 1962), cert. denied 371 U. S. 934. It is true that, as the taxpayers point out, *Revell* was an attempt by plaintiffs to enjoin the collection of income and excess profits taxes. The case thus has overtones of the policy expressed in § 7421 (a) of the 1954 Code against suits to restrain tax assessment or collection. And the court there specifically observed, p. 659, that it was not confronted by any question of the jurisdiction of the Tax Court. Nevertheless, because the requests for equitable relief centered in what was regarded as an absence of determinations, p. 657, "because of the conflicting tax deficiency determinations which were made in each case", the opinion does afford valuable precedent. The Ninth Circuit stressed that there was nothing in the notices which impugned the good faith of the Commissioner; that on the face of each notice it appeared that the determination "was thoughtful and considered"; that the burden on the several taxpayers of contesting the conflicting determinations was about the same as was imposed on any taxpayer dissatisfied with a notice of deficiency; that the bar of the statute of limitations lurks in the background; and that, p. 660, "We find

no legal or logical reason which compels the Commissioner to run such risk [of correct choice of theory] in the proper performance of his duty to protect the revenue". *Malat* is equally positive and, significantly, concerned petitions to review decisions of the Tax Court. It thus met the jurisdictional question directly. There the claim was made that jurisdiction did not exist because "by reason of the conflicting holdings by the Commissioner . . . either no determinations were made or the Commissioner acted arbitrarily and capriciously". The court cited *Revell,* referred to the statute of limitations, and held that the determinations were valid and that the taxpayers "properly invoked the jurisdiction of the Tax Court". P. 704 of 302 F. 2d.

8. We agree with the result reached by the Ninth Circuit.

9. The situation is far different than that condemned in James Couzens, 11 B. T. A. 1040, 1159 (1928), cited by the taxpayers. There the Board of Tax Appeals pointed out that the Commissioner testified that when he made the jeopardy assessments he "was not clear in his own mind that any tax was due".

10. We have encountered inconsistency of determinations before and have not been concerned or impressed with it. See *Meyer v. Commissioner,* 383 F. 2d 883, 885, 892 (8 Cir. 1967), affirming *Leon R. Meyer,* 46 T. C. 65 (1966). There are enough other instances in reported cases to indicate that alternative or contrary determinations in separate notices of deficiencies are not uncommon and have not been condemned by the courts. See *Commis-*

sioner v. Southwest Exploration Co., 350 U.S. 308, 309, footnote 1 (1956); *Commissioner v. Consolidated Premium Iron Ores, Ltd.*, 265 F. 2d 320 (6 Cir. 1959); *Nat Harrison Associates*, 42 T.C. 601, 617 (1964) (Commissioner's petition for review by the Fifth Circuit dismissed pursuant to stipulation); *Sanford Reffett*, 39 T.C. 869, 875 (1963) (taxpayers' petition for review by the Fourth Circuit dismissed pursuant to stipulation); *L. A. Thompson Scenic Ry.*, 21 B.T.A. 718 (1930).

'11. There is no avowed attempt here to collect more than one tax on the same income. We, as did the Tax Court, feel that it is clear that the determinations were in the alternative and that consistent legal principles were ultimately to be applied.

12. We do not regard the estate tax case as one with no actual determination of deficiency. The 90-day letter precisely proposed and, in so many words, "determined" a deficiency of $280,905.06 in estate tax. This was in part attributable to the Commissioner's limiting the deduction for income taxes of the decedent paid after death, and interest thereon to the date of death, to the amount not then being contested by the estate. The deficiency was thus computed without deduction for any additional pre-death income tax and interest which might later be agreed upon or judicially ascertained. Of course, such additional liability would constitute an appropriate estate tax deduction under § 812(b)(3) of the 1939 Code and would most certainly be claimed by the estate. This, however, does not make the Commissioner's determination something less than a full-fledged one which satisfies the stat-

ute. The situation is not unlike that concerning the 80% credit for state death taxes paid; this credit did not enter into the determination of deficiency but it was clear that it would be allowed, in reduction of the deficiency, upon the submission of proper proof of payment within the period provided by law. Although the years were passing, we place upon the Commissioner no positive duty here to fix the pre-death income tax liabilities with finality prior to his making an acceptable and statute-satisfying determination of estate tax deficiency. His action was not unreasonable.

We are satisfied that the jurisdiction of the Tax Court was properly invoked.

* * *

V. The first corporation issue. Does the record support the Tax Court's finding that, in each of its fiscal years 1950/54, inclusive, the corporation permitted its earnings and profits to accumulate beyond the reasonable needs of its business, within the meaning of § 102(c) of the 1939 Code?

We have recited above that the corporation assumed its present name in 1949; that it entered into the Manufacturing and Rental Agreement with the partnership in May of that year; and that under that agreement it took over the manufacturing business theretofore conducted by the partnership.

During each of the five fiscal years in question the corporation's capacitor sales amounted to more than 90% of its total sales. The corporation itself did not have a

contract with the Navy but it supplied capacitors to firms which possessed such contracts. It had five customers. The principal one was Eastman Kodak. Its gross sales of capacitors, its returned gross sales, and its returned taxable income were:

Fiscal Year Ended May 31	Gross Sales of Capacitors	Total Gross Sales	Returned Taxable Income
1950	$1,080,734.54	$1,185,689.54	$ 323,366.13
1951	2,474,708.18	2,686,280.23	754,934.46
1952	5,761,401.22	6,200,690.79	2,118,545.45
1953	5,280,247.13	5,663,073.05	1,458,268.97
1954	8,841,906.74	9,629,976.14	3,405,106.25

The balance sheets set forth in the returns filed by the corporation showed the following amounts of cash and earned surplus and undivided profits:

Fiscal Year Ended May 31	Cash	Earned Surplus and Undivided Profits
1950	$ 515,940.38	$ 323,366.13
1951	685,997.36	955,421.46
1952	2,269,514.88	1,138,748.37
1953	1,619,636.41	1,581,729.06
1954	3,198,585.98	2,528,642.29

No dividends were declared by the corporation during the five fiscal years. During these years, however, the Goodalls repeatedly withdrew corporate funds. They also made some repayments. Most of these withdrawals were utilized in partnership oil activities. The year-end balances of the withdrawals, as shown in the returns for

1950/53 and described therein as amounts due from officers, were:

Fiscal Year Ended May 31	Balance
1950	$ 203,043.48
1951	273,152.58
1952	309,696.15
1953	880,273.20

At May 31, 1954, the balance was approximately $1,660,000; $1,318,088.74 of this amount had been withdrawn for use in the oil ventures.

During this five year period the corporation was engaged in meeting technical problems in the reduction of the size and cost of capacitors and in designing a satisfactory enclosure for them.

In May 1961 the Commissioner notified the corporation, pursuant to § 534(b) of the 1954 Code,[8] that he proposed to issue for fiscal 1950/54 the statutory notice of deficiency in tax imposed by § 531 [§ 102(a) of the 1939 Code]. The corporation, as permitted by § 534(c), thereupon, by letter dated June 19, 1961, submitted its statement of the grounds on which it was relying to establish that its earnings and profits had not been permitted to accumulate beyond the reasonable needs of its business and thereby purported, under § 534(a)(2), to place the burden

8 Section 534 of the 1954 Code has no counterpart in the 1939 Code. Section 534(e), however, now makes § 534 applicable to the corporation's fiscal years 1950/54.

of this issue on the Commissioner. The grounds so stated were:

1. The need "to provide for the very large and undetermined liabilities to the United States Government for renegotiation of war contracts and for income and excess profits taxes and for the operational needs of the business".

2. The need "for the contemplated expansion of the business into other fields, the acquisition of other companies and businesses, and for the planned construction of factories in other countries".

3. The need "to provide against losses and costs of changing to different fields of manufacturing, to offset losses incident to termination of military contracts, and to supply the funds to obtain the necessary plant and equipment for the manufacture of civilian items, and to finance the development of a market therefor".

With its engagement in the manufacture of capacitors for Navy use, the corporation was subject to renegotiation under the Renegotiation Act of 1951 (see 50 U. S. C. App. § 1191). In March 1952 the Renegotiation Board notified the corporation that fiscal 1950 was being considered. In the following July it notified the corporation that it was commencing renegotiation proceedings for that year. No liability, however, was determined for fiscal 1950. In November 1954 the Board made a tentative determination of liability for fiscal 1951. Renegotiation as to that year was concluded in April 1955. Also, in that month, a notice of tentative determination was given for fiscal 1952; a final determination for 1952 was made by the Board in February 1956 and concluded in the ensuing fall. Preliminary notices of liability for fiscal 1953/54 were given in

March and May 1959, respectively, were finally determined that August, and were concluded in November 1959. The total of the tentative determinations for the five years was $1,500,900. The corporation's ultimately required repayments, net after credits under § 3806(b) of the 1939 Code, were:

Fiscal Year Ended May 31	Reduction in Net Income	Net Repayment After Credit under §3806(b) of the 1939 Code
1951	$ 275,000	$ 56,632.36
1952	1,200,000	360,000.00
1953	550,000	150,012.66
1954	1,100,000	411,912.33
	$3,125,000	$978,557.35

One readily sympathizes with the business problems of a corporation such as this one during the hectic years of the Korean War. Its business was concentrated in capacitor production. Even that aspect of its activity was largely confined to one customer. Orders were subject to cancellation and some were canceled. There were pressing and seemingly constant problems as to size, storage, construction, production, and costs of capacitors. Mr. Goodall's death was a most jarring event. There were competitive problems, too, and demand showed signs of volatility. Maintaining the corporation's share of the market depended upon ability to keep up with new developments, to deliver promptly, and to comply with changes required by the Navy.

The company, as any competent manufacturer then engaged in government work would be, was aware of its

renegotiation obligations and of the possible and seemingly inevitable result of renegotiation. It filed its contractor's reports with the Renegotiation Board. A conference with board representatives was held at Ogallala in the summer of 1952. And Mr. Goodall, in the first half of 1953, traveled to Europe and to Mexico to investigate the possibility of locating plants there for civilian use manufacture. A Mexican corporation had even been organized and a bank account opened in that country.

The Tax Court, however, decided the unreasonable accumulation issue against the taxpayer corporation. The court expressed doubt whether the facts set forth by the corporation in its responsive statement under § 534(c) were "sufficient to support the listed grounds" but went on to hold that even if it assumed that the burden of proof was on the Commissioner, he had successfully met that burden.

The Tax Court emphasized the absence of declaration of any dividends during the entire five year period; the increase in earned surplus and undivided profits from zero to more than two and a half million dollars; the Goodalls' complete control; their continuous withdrawal of corporate funds for their own or partnership purposes; the growth of these withdrawals to more than $1,600,000 by May 31, 1954; and the use of most of the withdrawals for the oil operations and thus "for purely personal expenditures or for other ventures of the Goodalls". The court observed, "Such continual use of the corporate funds strongly indicates, in our opinion, that its earnings and profits to this extent were not needed in the operation of the

corporation's business and that such amounts were accumulated beyond its reasonable needs within the meaning of the statute".

The court then examined the grounds stated by the corporation in justification of the accumulation. It concluded that none of them had merit. It was not convinced by the purported expansion plans because the trips Mr. Goodall made in 1953 were no more than exploratory; there was no showing that earnings accumulated in prior years were insufficient for this purpose; there was no showing that such expansion plans were contemplated formally; and any such plans evaporated when the decedent died in October 1953, seven months prior to the end of fiscal 1954. The court dismissed the factor of potential renegotiation liability because it was not until July 1952 (which was in fiscal 1953) that the corporation was first informed that fiscal 1950 was to be renegotiated; it was not until November 1954 (after the five fiscal years here involved) that the corporation was notified of a tentative determination for fiscal 1951; and management was not sufficiently concerned about these liabilities to establish a reserve for them. The court was not persuaded by the factor of income and excess profits tax liability because the Commissioner did not begin his audit of the fiscal years in question until September 1953, during the last of the fiscal years here involved, and the agent's report was not completed until some years later. Neither was the court convinced by the factor of need for operations because the corporation's cash account throughout the entire period was substantial and, when viewed against the background of constant withdrawals, indicated that the accumulation

was not to meet operational needs. It also touched upon the favorable working capital position, the nature of the current assets, and the sales pattern. Lastly, the court was not impressed with the claimed hazardous nature of the business. It noted that no reserves for this contingency had been set up; that there was no real indication that management was concerned about the hazard; that sales rose substantially during the period; that the sales pattern was generally upward; and that sales exceeded $9,000,000, not only in fiscal 1954 but also in the two succeeding fiscal years after the corporation had been sold.

The corporation first attacks the decision of the Tax Court by arguing (1) that there can be no § 102 surtax unless earnings and profits were accumulated beyond the reasonable needs of the business because, it says, this is the issue narrowly framed by the 90-day letter; (2) that, because of the filing of the § 534(c) statement, the Commissioner has the burden of proof; (3) that the court must find facts as to the corporation's earnings and profits and as to its reasonable business needs; and (4) that it failed to make a finding as to either of these essential facts.

Although we are inclined to share the Tax Court's concern about the legal sufficiency of the § 534(c) statement (under the statute's specification of "facts sufficient to show the basis thereof"), we are willing to assume, for purposes of this review, but without deciding, the first three of these four propositions advanced by the corporation. See *American Metal Prod. Corp. v. Commissioner*, 287 F. 2d 860, 861 (8 Cir. 1961). Having done this, we are not persuaded that the Tax Court failed to make find-

ings as to earnings and profits and reasonable business needs. On the contrary, it did find specifically what the corporation's records showed as to earned surplus and undivided profits at the end of each of the five fiscal years. It did find the amounts in the cash account on the same dates. It did find corporate inactivity as to that cash. An it did find that, to the extent of the withdrawals, earnings and profits "were not needed in the operation of the corporation's business and . . . such amounts were accumulated beyond its reasonable needs".

The heart of this preliminary argument by the corporation, however, seems to be that actual tax and renegotiation liabilities clearly enter, under § 102(d), into the determination of what is "section 102 net income" and therefore must first be provided for before a corporation can be said to have any earnings or profits, citing *W. S. Farish & Co.*, 38 B. T. A. 150, 156, 159 (1938), aff'd 104 F. 2d 833 (5 Cir. 1939), cert. denied 308 U. S. 559, and that a taxpayer's "mental attitude toward them is wholly immaterial".

We are not prepared to hold that there must be a finding of specific monetary amount for the reasonable needs of the business before, and as a condition of, a finding that there has been an accumulation of earnings beyond reasonable business needs. The latter may clearly appear without a dollar and cents determination of the former. And it would not make good tax law to hold, as we think is the ultimate implication of the corporation's argument, that there may be unlimited accumula-

tion so long as the possibility of further tax or renegotiation liability exists and is undetermined. We see nothing of meritorious substance, therefore, in the argument that the Tax Court failed to find facts essential for a decision.

This takes us to the real issue under § 102, namely, whether the court's decision finds adequate support in the record.

The governing legal principles are established. The purpose of the surtax, of course, is to compel a corporation to distribute profits not needed for its business and to prevent its being used as a shield against the income tax on the shareholders. *Helvering v. Chicago Stock Yards Co.*, 318 U. S. 693, 699 (1943). Where the question of tax liability centers on an accumulation of earnings and profits "beyond the reasonable needs of the business", the issue is essentially one of fact. *Kerr-Cochran, Inc. v. Commissioner*, 253 F. 2d 121, 124 (8 Cir. 1958); *American Metal Prod. Corp. v. Commissioner*, supra, p. 864 of 287 F. 2d. Consequently, the Tax Court determination is conclusive if supported by substantial evidence. *Helvering v. National Grocery Co.*, 304 U. S. 282, 294 (1938); *American Metal Prod. Corp. v. Commissioner*, supra; *Kerr-Cochran, Inc. v. Commissioner*, supra; *Hedberg-Freidheim Contracting Co. v. Commissioner*, 251 F. 2d 839, 842 (8 Cir. 1958).

In *American Metal Prod. Corp. v. Commissioner*, supra, p. 863 of 287 F. 2d, we noted that "while the ultimate determination concerns the presence of a purpose to avoid income tax on shareholders, the real controversy, as per-

haps is the situation in most cases of this type, concerns the presence or absence of a valid business reason for accumulating earnings".

Section 537 of the 1954 Code defines the term "reasonable needs of the business" to include "the reasonably anticipated needs of the business". This had no counterpart in the 1939 Code. Accordingly, where, as here, we are concerned with tax years governed by the 1939 Code, the factfinder was not particularly obliged to consider anticipated needs in its determination of reasonable needs. This court, in *Kerr-Cochran, Inc. v .Commissioner,* supra, pp. 123-24 of 253 F. 2d, noted this distinction between the two Codes and participated in the so-called "immediacy doctrine". 7 Mertens, Law of Federal Income Taxation, § 39.50 (1967). In considering the 1939 Code we, through Judge Johnsen, spoke of "a practical and objective basis" and "immediacy of need" which "does not go farther than direct and present apparency", and which does not 'reach to visionary hopes or ambitions, nor does it compel blind acceptance of marked sweeps from previous rudder course".

The corporation, in claiming that the Tax Court decision on the § 102 issue is not supported by the evidence, argues that the figures, if the court had only set them down, disclose that the corporation was actually suffering from a capital deficiency and therefore cannot appropriately be accused of excessive accumulation of earnings, and that this is so wholly apart from its needs for plant expansion, the Commissioner's tax demands, interest thereon, renegotiation liability, and required protection

from the hazardous and changing nature of the business. It would then demonstrate, by an elaborate table, its needs for additional capital over and beyond that originally contributed plus earnings, and without taking into account the pending demands just enumerated. It goes on and asserts that the renegotiation and tax liabilities are necessarily deductible in arriving at actual earnings and are business needs irrespective of whether they prompted the accumulations.

The weakness of the corporation's fiscal table and ensuing argument lies, we think, in its being based on events and developments of days long subsequent to the five year period at issue. The compilation rests on claimed working capital requirements of substantial size, on the Tax Court's 1965 decision herein, and on the Rule 50 results. The capital requirements are those developed by a Peat, Marwick partner who testified that he first did work for the Goodalls in late 1956 and developed his figures, on a 90-day turnover basis, just prior to trial. He conceded this to be "a judgment factor".

Our governing standard is whether earnings were permitted to accumulate beyond the reasonable needs of the business focused, as Judge Johnsen said in *Kerr-Cochran, Inc. v. Commissioner*, supra, on "a practical and objective basis" and on "immediacy of need". We do not mean to imply that liabilities currently incurred but presently indefinite and to be fixed only in the future, may not be taken into account in exercising the business judgment whether to accumulate or to disburse, or to do a bit of both. That, of course, is a decision a business-

man makes almost daily. But there must be, particularly under the 1939 Code and, we suspect, even under § 537 of the 1954 Code, a realistic reasonableness of action before the shoals of § 102 are to be successfully avoided. *Dixie, Inc. v. Commissioner*, 277 F. 2d 526, 528 (2 Cir. 1960); 7 Mertens, Law of Federal Income Taxation, § 39.32 (1967). We find this realism absent here.

The following lend adequate support to the finding of the Tax Court: (1) As of the end of fiscal 1953 the corporation possessed cash in the amount of $1,619,636.41 and, in addition, amounts due from officers (the withdrawals by the Goodalls) of $880,273.20. (2) At the end of fiscal 1954 it had $3,198,585.98 in cash (the return makes no specific reference to amounts then due from officers). (3) These figures had grown from a beginning cash figure on June 1, 1949 of $387,806.86. (4) The corporation was wholly owned by the partnership and was completely controlled by the Goodalls. (5) Funds of the corporation were regularly loaned to the officers-shareholders-partners and reached very substantial totals. (6) Substantial portions of the funds so advanced were utilized and activated not for corporation-related matters but for unrelated ventures of the partnership and other personal uses of the Goodalls. (7) The balance sheet ratios of current assets to current liabilities was consistently very favorable. (8) The corporation appeared always to be in an enviable liquid position. (9) No reserves were established for renegotiation liability. (10) No dividends were declared. (11) No corporate meetings were held until after Mr. Goodall's death. (12) Substantial tax savings to the Goodalls were possible through accumula-

tion. (13) The suggested expansion plans were never brought to fruition and progressed to no more than the investigational stage. (14) The corporation performed comparatively little research. (15) The audit of its income tax returns was not begun until September 1953, in the last year of the five year period, and the Revenue Agent did not complete his work until some years later. (16) The first notice of preliminary consideration from the Renegotiation Board came in March 1952 and concerned fiscal 1950 but resulted in no renegotiation liability. (17) The earliest notice of a tentative determination of liability for a year when liability was ultimately established came only in November 1954, after the close of the five fiscal years. (18) Renegotiation was concluded for fiscal 1951 only in April 1955, for fiscal 1952 only in the fall of 1956, and for fiscal 1953/54 only in November 1959. (19) The net repayments totalled less than a million dollars. (20) The Board, by the concluding agreement, permitted the repayments for fiscal 1953/54 to be spread over fiscal years 1960/64, and thus for as long as ten years after the period. (21) This period of time embraced several years the profits of which were available to meet the obligation. (22) There is nothing in the record which discloses a disturbed concern on the Goodall's part, during the five years, about liabilities for renegotiation and tax deficiencies or even about the asserted capital needs requirement which the retained accountant developed later for the Tax Court trial and which were based on his good judgment and experience. (23) Actual working capital needs appear to have been well taken care of by cash flow.

There are, of course, possible explanations for some of these factors (the informality of record keeping, the absence of outside ownership interests, fiscal 1954's returned income tax liability of $2,124,327.81, and the like). But on a review of evidentiary sufficiency, the record is examined in the light most favorable to the party prevailing below. And we deal again with the Tax Court's "experience with the mainsprings of human conduct to the totality of the facts". *Commissioner v. Duberstein*, supra, p. 289 of 363 U. S.

The decided cases are supportive. One or more of these same factual elements, sometimes several in combination, are present and relied upon, for example, in the following: *Helvering v. National Grocery Co.*, supra, 304 U. S. 282, 292-94 (1938) (excess of cash over payables; tax savings; loans to the sole shareholder; "no conceivable expansion could have utilized so large a surplus"); *Helvering v. Chicago Stock Yards Co.*, supra, 318 U. S. 693, 701 (1943) (the availability of accumulated earnings for the investment purpose and program of the sole shareholder; tax savings); *American Metal Prod. Corp. v. Commissioner*, supra, 287 F. 2d 860, 863-65 (8 Cir. 1961) (failure to carry out program for enlarged accounts receivable and plant expansion; full control; possible tax savings; extreme liquidity; favorable ratio of current assets to liabilities; very small dividends); *Kerr-Cochran, Inc. v. Commissioner*, supra, 253 F. 2d 121, 125-28 (8 Cir. 1958) (loans to shareholders; use of earnings to buy investment property not related to regular business; favorable ratio between current assets and current liabilities; absence of extension of credit causing a freezing of work-

ing funds; tax saving); *Bride v. Commissioner,* 224 F. 2d 39, 41-42 (8 Cir. 1955), cert. denied 350 U. S. 883 (absence of an objective which demanded an accumulation in a reasonably definite amount; possible tax savings); *J. Gordon Turnbull, Inc. v. Commissioner,* 373 F. 2d 87 (5 Cir. 1967), cert. denied 389 U. S. 842, affirming 41 T. C. 358, 374 (1963) (favorable current asset-liability ratios; small ultimate tort liability as compared with amount originally asserted; use of funds to purchase own stock); *Oyster Shell Prod. Corp. v. Commissioner,* 313 F. 2d 449 (2 Cir. 1963) (substantial withdrawals; absence of interest charge or note; investments by the shareholders); *Henry Van Hummell, Inc. v. Commissioner,* 364 F. 2d 746, 751 (10 Cir. 1966), cert. denied 386 U. S. 956 (absence of demonstration of taxpayer's intent through contemporaneous course of conduct; adoption of no plan). See Treas. Regs. § 1.533-1 (a) (2); 7 Mertens, Law of Federal Income Taxation, §§ 39.34 and .49; Luria, The Accumulated Earnings Tax, 76 Yale L. J. 793 (1967).

In *Smoot Sand & Gravel Corp. v. Commissioner,* 241 F. 2d 197, 202 (4 Cir. 1957), cert. denied 354 U. S. 922, the court referred to expansion plans and intent. It said,

> "The intention claimed must be manifested by some contemporaneous course of conduct directed toward the claimed purpose. . . . Here the petitioner failed to show that it had during the period . . . any definite plan for future replacement and expansion out of reserves."

We affirm the Tax Court on this issue.

VI. The second corporation issue. Does the record support the Tax Court's finding that, in each of its fiscal

years 1950/54, inclusive, the corporation was availed of for the purpose of preventing the imposition of surtax upon its shareholders, within the meaning of § 102 (a)?

Having concluded that earnings and profits were permitted to accumulate beyond the reasonable needs of the corporation's business, the Tax Court then considered the question whether the purpose of the accumulation was to avoid surtax upon shareholders. It concluded that the corporation had not met its burden of proof in this respect.

Under § 533 (a) of the 1954 Code the fact, once established, that earnings and profits have been permitted to accumulate beyond the reasonable needs of the business is determinative of the purpose to avoid income tax with respect to shareholders unless the corporation "by the preponderance of the evidence shall prove to the contrary". In the corresponding § 102 (c) of the 1939 Code, which governs here, the standard was "the clear preponderance of the evidence". We are confronted, therefore, with what appears to be a stricter statutory presumption and standard of proof under the 1939 Code. This burden as to purpose is evidently on the corporation rather than on the Commissioner. *Pelton Steel Casting Co.*, 28 T. C. 153, 183 (1957), aff'd 251 F. 2d 278 (7 Cir. 1958), cert. denied 356 U. S. 958.

Here, again, we have no difficulty in going along with the Tax Court's finding and we conclude that it, too, is adequately supported by the record. This support is afforded by many of the same factors listed above and by others: (1) The Goodalls' own high income brackets.

(2) The tax advantage to be gained by an absence or minimization of corporate distributions. (3) The Goodalls' complete dominance and control. (4) Their constant and growing withdrawal of corporate funds for personal expenses and ventures, some highly speculative, unrelated to the corporation. (5) The year-end calculation of the difference between rents and salaries owing to the Goodalls and the withdrawals actually made, and denominating that difference as a loan without other formality or exercise of business judgment as to amount or as to the advisability of distribution. (6) The ability to repay. (7) The eventual repayment, after Mr. Goodall's death, of the balance of the withdrawals just when the sale to the five employees and their $3,000,000 borrowing required it. (8) The low ratio of reasonably projected liability to available funds. In addition to these factors there is the statutory presumption of § 102 (c).

We are satisfied that the finding as to purpose is a proper one and, indeed, that not only the preponderance of the evidence but the clear preponderance of it did not overcome but fully supported the statutory presumption.

VII. The third corporation issue. Did the Tax Court err in its compilation of the § 102 surtax?

This issue breaks down into two sub-issues: (A) Are federal income and excess profits taxes, which were also in controversy in the proceedings in the Tax Court, a proper deduction in the computation of section 102 net income? (B) In determining basic surtax credit, is the corporation entitled to a dividends paid addition for certain withdrawal items?

A. The surtax imposed by § 102 (a) is computed by percentages of "undistributed section 102 net income". In turn, "section 102 net income" is defined by § 102 (d) (1) to mean the net income (adjusted for two factors of no consequence here) minus the sum of certain taxes and other items therein described. The taxes are, by § 102 (d) (1) (A), "Federal income . . . and excess-profits taxes . . . paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section. . . ." Section 23 (c) (1) (A) denies a deduction for federal income taxes in the computation of net income. Consequently, such taxes, denied under § 23, are allowed in computing "section 102 net income". The purpose, of course, is to arrive at a realistic determination of improper accumulation and what a corporation has properly paid or accrued for federal income taxes reduces the accumulation accordingly.

As to this generality there is no argument. The controversy here centers on what may be regarded as federal income taxes of the corporation properly "paid or accrued during the taxable year". The Commissioner's 90-day letter, dated September 27, 1961, to the corporation determined deficiencies in the corporation's normal tax and surtax (as well as in § 102 surtax). Because it kept its books and filed its returns on the accrual basis, the corporation here asserts that these deficiencies, to the extent they have been upheld in the present Tax Court proceedings (that is, its "actual liability"), are deductions in the determination of what is section 102 net income. The corporation thus wants a deduction for the

additional taxes (other than the § 102 surtaxes) contested in this litigation.

We think the point is controlled by *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516 (1944). There an accrual basis taxpayer contested a state tax. The Court said, p. 519, applying what it has called the "all events test":

> "It has never been questioned that a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which really accrues in the taxable year. It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer. . . . It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated." [footnotes omitted].

To like effect are *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281, 284 (1944), and *United States v. Consolidated Edison Co.*, 366 U. S. 380 (1961). See S. Rep. 1622, 83d Cong. 2d Sess., p. 320, 3 U. S. Code Congressional & Administrative News (1954), pp. 4621, 4960-61, where it was said, with respect to undistributed personal holding company income, "In the case of contested taxes the accrual occurs in the year the contest is resolved", and *Mills, Inc. v. Commissioner*, 250 F. 2d 55 (1 Cir. 1957).

Our case of *Birmingham v. Loetscher Co.*, 188 F. 2d 78 (8 Cir. 1951), and others cited by the corporation, are

not contrary holdings. In *Birmingham* we held merely that a cash basis personal holding company taxpayer could deduct, under the applicable statute, an uncontested surtax in the year in which it accrued. The statute, § 505 (a) (1) of the 1939 Code, was, for all essential purposes, the same as § 102 (d) (1) (A). But that holding was merely in line with accepted principles applied in the light of the particular statute. The taxes claimed to be deductible were not in contest.

We sustain the Commissioner as to this sub-issue.

B. "Undistributed section 102 net income", on which the surtax of § 102 (a) is imposed, is defined by § 102 (d) (2) to mean "the section 102 net income minus the basic surtax credit provided in section 27 (b). . . ." In the computation of the basic surtax credit under § 27 (b), dividends paid during the taxable year are an includable component but § 27 (h) requires, for this result, that the distribution be pro rata.

This issue centers on certain withdrawals by the Goodalls from the corporation, namely, (a) those stipulated to be excess salary paid to Mrs. Goodall, and (b) those stipulated as "unrecorded withdrawals". The Tax Court held that these obviously were not made pro rata and thus did not qualify as dividends paid.

We conclude, however, that the partnership agreement, the legal efficacy of which is now accepted by the Commissioner, supra, controls here. It provides that Mr. and Mrs. Goodall share equally and are equally liable. Their salaries were partnership income and these and the

other withdrawals were taxed to the partners through the partnership, in accord with the partnership agreement and § 182 (c). Further, the partnership was the sole shareholder. All this determines and fixes the rights as between the Goodalls. The items are necessarily pro rata; they cannot be otherwise.

We sustain the corporation as to this sub-issue.

* * *

The decisions of the Tax Court in all six cases are therefore vacated. The cases are remanded for redetermination in accord with the conclusions hereinabove reached. Specifically, and in summary:

* * *

2. In the corporation case (our No. 18,636; Tax Court No. 95458) undistributed section 102 net income is to be computed with the basic surtax credit including the excessive salary and unrecorded withdrawals to which Part VI B of this opinion relates.

* * *

4. All other computational corrections which follow upon or are required by the foregoing adjustments, shall, of course, be made.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX C

TAX COURT OF THE UNITED STATES

Washington

Docket No. 95458

GOOD-ALL ELECTRIC MFG. CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the opinion of the Court filed June 4, 1965, the parties filed computations for entry of decision and it appearing that respondent's computation correctly reflects the petitioner's tax liabilities; and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes due from the petitioner for its taxable years ending May 31, 1950, May 31, 1951, May 31, 1952, May 31, 1953, and May 31, 1954, in the amounts of $111,060.00, $224,353.01, $166,325.77, $444,856.95, and $143,350.68, respectively.

(Signed) JOHN E. MULRONEY
JOHN E MULRONEY
Judge

Entered: July 26, 1966

APPENDIX D

T. C. Memo. 1965-154

TAX COURT OF THE UNITED STATES

ESTATE OF ROBERT A. GOODALL, C. M. GOODALL, Executrix, et al.,[1] Petitioners, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 72361, 95387, 95388, 95458, 3142-63, 3143-63. Filed June 4, 1965

James W. R. Brown and *William J. Brennan, Jr.*, for the petitioners.

Claude R. Wilson, Jr., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

MULRONEY, *Judge*: Respondent determined deficiencies and additions to tax as follows:

* * *

Petitioner	Docket No.	Fiscal Year Ended May 31	Income Tax Deficiencies
Good-All Electric Mfg. Co.	95458	1950	$126,935.74
		1951	272,135.53
		1952	375,793.77
		1953	622,842.49
		1954	646,528.93

1 The following proceedings are consolidated herewith: ESTATE OF ROBERT A. GOODALL, Deceased, CLARICE M. GOODALL, Executrix, Docket Nos. 95387 and 3142-63; ESTATE OF ROBERT A. GOODALL, Deceased, CLARICE M. GOODALL, Executrix, and CLARICE M. GOODALL, Docket No. 95388; GOOD-ALL ELECTRIC MFG. CO., Docket No. 95458; and C. M. GOODALL, Docket No. 3143-63.

The issues in these consolidated cases are: * * * (5) whether the partnership income of R. A. and C. M. Goodall should be increased by treating certain withdrawals from Good-All Electric Mfg Co. as dividends rather than loans; * * * (9) whether respondent correctly disallowed a deduction for a portion of the purported rental payments made by Good-All Electric Mfg. Co. to the partnership of R. A. and C. M. Goodall in the fiscal years ended May 31, 1950 through 1954; (10) whether Good-All Electric Mfg. Co. was availed of to avoid or prevent the imposition of income tax on its stockholders within the meaning of section 102 of the Internal Revenue Code of 1939 in the fiscal years ended May 31, 1950 through 1954; (11) whether Good-All Electric Mfg. Co. is entitled to a dividends-paid deduction under sections 27 and 102 (d) (2) of the Internal Revenue Code of 1939 for any of the taxable years before us; * * *.

FINDINGS OF FACT

Some of the facts were stipulated and they are so found.

Robert A. Goodall and Clarice M. Goodall, husband and wife, were residents of Ogallala, Nebraska, until the date of Robert's death, October 22, 1953. Clarice has remained a resident of Ogallala, Nebraska. Robert and Clarice filed joint income tax returns for the years 1949 through 1952 with the Collector of Internal Revenue or the District Director of Internal Revenue in Omaha, Nebraska. A joint return was filed by Robert A. Goodall (deceased) and Clarice M. Goodall with the District Director in Omaha, Nebraska, for the year 1953. Clarice

filed her income tax returns for the years 1954 through 1959 with the District Director of Internal Revenue at Omaha, Nebraska.

* * *

Good-All Electric Mfg. Co., a Nebraska corporation, filed its corporation income tax returns for the taxable years ending May 31, 1950 through 1954 with the Collector of Internal Revenue or the District Director of Internal Revenue in Omaha, Nebraska. Good-All Electric Mfg. Co. used an accrual method of accounting.

On and immediately prior to May 28, 1949, the principal products being manufactured and sold by the partnership of R. A. and C. M. Goodall were (1) capacitors, (2) cathodic protection rectifiers, (3) soldering machines, (4) watch-cleaning machines and (5) fishing reels. Robert and Clarice were equal partners in the partnership. The manufacturing operations were carried on in two plants owned by the partnership in Ogallala, Nebraska. The capacitors manufactured by the partnership on and prior to May 28, 1949, were for proximity fuses for the United States Navy Department. The partnership had been approved by the Navy Department as an authorized supplier of capacitors for military purposes.

On May 11, 1940, Robert and Clarice formed a corporation known as Ogallala Industries, Inc. The corporation did not conduct any business operations and its charter was allowed to lapse on December 30, 1944. Its corporate existence was revived on November 21, 1947, and on April 8, 1949, the Articles of Incorporation of Ogallala Industries, Inc. were amended to change the

corporate name to Good-All Electric Mfg. Co. and to make other changes.

On May 28, 1949, the partnership of R. A. and C. M. Goodall and Good-All Electric Mfg. Co. executed a Manufacturing and Rental Agreement under which the corporation took over the operation of the partnership business. The agreement provided, in part, as follows:

MANUFACTURING AND RENTAL AGREEMENT

WHEREAS the "Good-All Electric Mfg. Co." of Ogallala, Nebraska hereinafter referred to as the party of the first part is desirous of engaging in the manufacture and sale of products formerly made by the partnership of R. A. and C. M. Goodall dba "Goodall Electric Mfg. Co." hereinafter referred to as the party of the second part of the partnership.

* * *

THEREFORE it is now agreed that the party of the first part shall be granted the right to produce such materials and products as were formerly made by the party of the second part subject to the provisions of the sections listed below:

Section 1. The party of the first part shall pay to the partnership an amount equal to 5% of the gross sales of the party of the first part. It is understood that this 5% hereinafter referred to as the commission is being paid for the use of the trade name, plant and equipment formerly used by the partnership in lieu of any royalties for the privilege of manufacturing such products and for the benefit of the industrial "know-how" of the engineers and employees of the partnership.

Section 2. All expenses of upkeep and maintenance of the building and equipment including insurance, taxes and necessary repairs are to be paid by the party of the first part in addition to the 5% commission as set forth in Section 1.

Section 3. Party of the first part agrees that it will employ no one other than R. A. Goodall and C. M. Goodall during such time as this agreement is in force. The partnership is to employ all other personnel used by party of the first part and will be reimbursed for all employees' salaries, payroll taxes and workmen's compensation insurance paid in connection with the use of the employees of the party of the second part by the party of the first part. It is agreed that in order to simplify the bookkeeping, the party of the first part may, at its election, make all such payments direct provided it is clearly understood between the parties signing this agreement that the party of the second part is at all times the employer of all personnel used by the first party except the two individuals named at the beginning of this section.

The agreement was executed by Robert A. Goodall and Clarice M. Goodall as President and Secretary-Treasurer, respectively, of Good-All Electric Mfg. Co., and by the same two parties in their capacities as partners of the R. A. and C. M. Goodall partnership.

Good-All Electric Mfg. Co., throughout the years before us, engaged solely in the manufacture of capacitors, cathodic protection rectifiers, electric soldering machines, watch-cleaning machines and fishing reels. For approximately the first three years of the operation of Good-All Electric Mfg. Co. (hereinafter sometimes called Good-All)

its transactions continued to be recorded on the partnership books, which were used as the basis for computing the corporation's income. No stock was issued by Good-All until some time during its fiscal year ended May 31, 1953, when 300,000 shares of stock were issued to Robert and Clarice (150,000 shares to each) in their capacities as partners in the R. A. and C. M. Goodall partnership.

During each of the fiscal years ended May 31, 1950 through 1954 Good-All's capacitor sales amounted to more than 90 percent of its total sales. Good-All's gross sales of capacitors during these fiscal years were as follows:

Fiscal Year ending May 31	Gross Sales of Capacitors
1950	$1,080,734.54
1951	2,474,708.18
1952	5,761,401.22
1953	5,280,247.13
1954	8,841,906.74

The capacitors were for use in a proximity fuse under a Navy ordnance contract. Good-All itself did not have any contract with the Navy but supplied capacitors to firms which did have such contracts. During the years here involved Good-All had five customers for its capacitors, with Eastman Kodak as the principal customer. Good-All's principal competitors during these years were Sprague Electric Company, Aerovox Corporation and Cornell-Dubilier Corporation.

During the years here involved Good-All was constantly engaged in reducing the size and cost of the capacitors and in meeting the production problems created by

such efforts. Good-All also worked on problems involving a satisfactory enclosure for the capacitors.

During the summer of 1953 Robert made a trip to England to investigate the possibilities of establishing a plant there in connection with the Good-All Electric Mfg. Co. These plans were abandoned as a result of Robert's death in October, 1953. Robert also made several trips to Mexico in 1953 to investigate the possibility of establishing a plant there in connection with the Good-All Electric Mfg. Co. A corporation was formed in Mexico and two bank accounts were opened in Mexico in May, 1953, with total deposits of $2,315.14. At the same time a bank account in the amount of $34,236 was opened in an El Paso, Texas, bank. The plans to open a Mexican plant were subsequently abandoned.

In March, 1952, the Renegotiation Board notified Good-All that, pursuant to the Renegotiation Act of 1951, its fiscal year ending May 31, 1950, was being considered by the Board. On July 29, 1952, the Board notified Good-All that the Board was commencing renegotiation proceedings with respect to Good-All's operations for the fiscal year 1950. By January, 1954, Good-All's fiscal year ending May 31, 1951, was before the Board. In November, 1954, the Board notified Good-All of a tentative determination for the fiscal year 1951, and in April, 1955, an agreement was reached by Good-All and the Board for the fiscal period ended May 31, 1951. In February, 1956, the Renegotiation Board notified Good-All of the final determination involving Good-All's fiscal year ended May 31, 1952, and in August, 1959, the Renegotiation Board notified Good-All of the final determinations for Good-

All's fiscal years ended May 31, 1953 and 1954. As a result of the renegotiations the net income of Good-All was reduced, credits were allowed under section 3806 (b) of the Internal Revenue Code of 1939 (for taxes paid on higher income), and Good-All was required to repay the amounts as follows:

Fiscal Year Ended May 31	Reduction in Net Income	Credit under sec. 3806 (b) of the 1939 I.R.C.	Net Repayment
1951	$ 275,000	$218,367.64	$ 56,632.36
1952	1,200,000	840,000.00	360,000.00
1953	550,000	399,987.34	150,012.66
1954	1,100,000	688,087.67	411,912.33

Good-All reported the following amounts of taxable income on its corporation income tax return filed for its fiscal years ended May 31, 1950 through 1954, respectively: $323,366.13, $754,934.46, $2,118,545.45, $1,458,268.97 and $3,405,106.25.

The balance sheets included in the returns filed by Good-All for its fiscal years ended May 31, 1950 through 1954 show the following amounts of (1) cash and (2) earned surplus and undivided profits:

Fiscal Year Ended May 31	Cash	Earned Surplus and Undivided Profits
1950	$ 515,940.38	$ 323,366.13
1951	685,997.36	955,421.46
1952	2,269,514.88	1,138,748.37
1953	1,619,636.41	1,581,729.06
1954	3,198,585.98	2,528,642.29

No dividends were declared by Good-All during its fiscal years ending May 31, 1950 through 1954. In their joint returns for 1950 through 1954, Robert and/or Clarice reported adjusted gross income in the respective amounts of $148,275.95, $59,382.42, $49,091.08, $391,289.94 and $541,987.63.

During the fiscal years of Good-All ending May 31, 1950 through 1954, Robert and Clarice continually withdrew corporate funds for their own or partnership purposes. Most of the money so withdrawn from the corporation by the Goodalls was used for the Goodall Oil Co., which was owned by the partnership. As of June 1, 1954, the outstanding balance of withdrawals from the corporation for use by the Goodall Oil Co. was $1,318,088.74. The outstanding balances of withdrawals from the corporation through the fiscal year ended May 31, 1953, as shown in the corporation's income tax returns as amounts due from its officers, were as follows:

Fiscal Year Ended May 31	Balance
1950	$203,043.48
1951	273,152.58
1952	309,696.15
1953	880,273.20

As of May 31, 1954, the outstanding balance of withdrawals from Good-All was approximately $1,660,000. On June 2, 1954, Clarice executed a check payable to Good-All in the amount of $1,662,977.74.

Respondent determined in Docket No. 95388 (Estate of Robert A. Goodall and Clarice M. Goodall, individually, for the years 1950 through 1953) and in Docket No. 95387 (Estate of Robert A. Goodall, for the year 1953) that the amounts withdrawn from the corporation were taxable as dividends in the following amounts:

Year	Amount
1950	$ 240,648.55
1951	405,300.99
1952	390,340.91
1953	1,222,652.22

As a result of stipulated concessions by the respondent, the withdrawals were reduced to the following amounts:

Year	Amount
1950	$ 215,075.83
1951	388,193.95
1952	242,230.68
1953	1,075,155.68

In Vol. 3 of the stipulations the petitioners in Docket Nos. 95387 and 95388 concede "that the partnership had unrecorded withdrawals in the following amounts which are dividends to the extent that the corporation had earnings and profits:

1950	$ None
1951	5,075.10
1952	17,699.27
1953	1,432.37"

By letter dated May 8, 1961 the respondent notified Good-All pursuant to section 534 of the Internal Revenue Code of 1954 that he proposed to issue a statutory notice of deficiency for the fiscal years ended May 31, 1950 through 1954 with respect to the accumulated earnings tax imposed by section 531 of the Internal Revenue Code of 1954.

Good-All Electric Mfg. Co. (Docket No. 95458) filed a statement with respondent under section 534(c) of the Internal Revenue Code of 1954 of the grounds on which the corporation relied to establish that all or any part of its earnings for the fiscal years ending May 31, 1950 through 1954 were not permitted to accumulate beyond the reasonable needs of its business.

Respondent determined that Good-All Electric Mfg. Co. "was availed of for the purpose of preventing the imposition of the surtax upon its shareholders under section 102 of the Internal Revenue Code of 1939 through the medium of permitting its earnings or profits for the taxable years ended May 31, 1950, May 31, 1951, May 31, 1952, May 31, 1953, and May 31, 1954, to accumulate beyond the reasonable needs of its business instead of being divided or distributed to your shareholders."

Respondent disallowed a portion of the payments made by Good-All to the partnership of R. A. and C. M. Goodall under the Manufacturing and Rental Agreement in each of the fiscal years ended May 31, 1950 through 1954. Respondent explained these adjustments as follows:

[Fiscal Year ended May 31, 1950]
(a) The deduction of $59,827.41 claimed on your return as rent is disallowed to the extent of $31,774.03 because it has not been established that the amount in excess of $28,053.38 constitutes an ordinary and necessary business expense. * * *

* * *

[Fiscal Year ended May 31, 1951]
(a) The deduction of $134,314.01 claimed on your return as rent is disallowed to the extent of $98,812.13 because it has not been established that the amount in excess of $35,501.88 constitutes an ordinary and necessary business expense. * * *

* * *

[Fiscal Year ended May 31, 1952]
(a) The deduction of $308,607.30 claimed on your return as rent is disallowed to the extent of $263,644.37 because it has not been established that the amount in excess of $44,962.93 constitutes an ordinary and necessary business expense. * * *

* * *

[Fiscal Year ended May 31, 1953]
(a) The deduction of $283,153.65 claimed on your return as rent is disallowed to the extent of $218,340.64 because it has not been established that the amount in excess of $64,813.01 constitutes an ordinary and necessary business expense. * * *

* * *

[Fiscal Year ended May 31, 1954]
(a) The deduction of $481,280.05 claimed on your return as rent is disallowed to the extent of $382,226.43 because it has not been established that the

amount in excess of $99,053.62 constitutes an ordinary and necessary business expense. * * *

* * *

Some time prior to June 1954 five employees of Good-All made an offer to purchase the Good-All stock for approximately $3,000,000. This offer was subsequently accepted. On or about June 2, 1954, 275,000 shares of Good-All stock were sold by the estate to the five individuals, while the 25,000 shares of stock held by Clarice were redeemed by the corporation. The five purchasers borrowed about $55,000 from a bank to finance a portion of the purchase price. The balance of the purchase price for the 275,000 shares of stock, approximately $2,800,000, was borrowed from the corporation, with notes given back to the corporation which were secured by the 275,000 shares of stock.

Under a new lease agreement entered into on June 4, 1954 by the partnership of R. A. and C. M. Goodall and Good-All, the real estate, machinery and equipment which were owned by the partnership and were being used by the corporation were rented to the corporation for "an amount equal to 3% of the gross sales of all products manufactured on or in said real estate or manufactured by said machinery and equipment." At the same time the partnership granted to Good-All an option to purchase the real estate and machinery at a price which would be their fair market value as of June 1, 1954.

* * *

OPINION

These cases involve related taxpayers and the re-

spondent has found it necessary to make inconsistent determinations as between different taxpayers in the different docket numbers. It is clear that such determinations are made in the alternative, and it is equally clear that once a holding is reached on an issue it will be applied consistently where more than one taxpayer is involved. There is no merit in petitioners' contentions that, where respondent chose to make alternative determinations, respondent failed in his statutory duty to make a proper determination or that he somehow failed to raise issues properly, thereby causing the burden of proof to shift to him. Nor do we accept petitioners' argument that respondent, by making alternative determinations, is acting capriciously and in an arbitrary manner.

Similar contentions were rejected by this Court in *Nat Harrison Associates, Inc.*, 42 T. C. 601, 617, where we stated the following:

> Petitioner does contend, however, that respondent's various determinations with respect to the various taxpayers, which admittedly would subject to tax considerably more income than the total net profits from the three jobs, are thereby shown to be conflicting, arbitrary, and unreasonable and hence are not entitled to any presumption of correctness, relying primarily on *Helvering v. Taylor*, 293 U. S. 507 (1935). In his opening statement counsel for respondent made it clear that the determinations were in the alternative and that respondent did not contend that the net profit from the contracts should be taxed more than once. Occasions often arise where, in order to protect the revenue, respondent must make alternative determinations which have the effect of taxing income more than once. We do not think respondent's

alternative determinations under the circumstances here present were arbitrary, capricious, or unreasonable. See *Malat v. Commissioner*, 302 F. 2d 700 (C. A. 9, 1962), affirming 34 T. C. 365 (1960), certiorari denied 371 U. S. 934 (1962), and *Revell, Inc., v. Riddell*, 273 F. 2d 649 (C. A. 9, 1959). Consequently, the presumption that respondent's determinations are correct would not be lost for that reason alone. * * *

We are satisfied, from an examination of the notices of deficiency in all the docket numbers, that the determinations were properly made and that the presumption of correctness attaches to such determinations. *Welch v. Helvering*, 290 U. S. 111.

* * *

The next issue which involves the Good-All Electric Mfg. Co. in Docket No. 95458 is whether the corporation was availed of during its fiscal years ended May 31, 1950 through 1954 for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting earnings and profits to accumulate instead of being divided or distributed. Section 102 of the 1939 Internal Revenue Code. Respondent contends that the earnings and profits of the corporation were permitted to accumulate beyond the reasonable needs of the business during each of these years. Respondent mailed a notification under section 534(b) of the 1954 Internal Revenue Code to the corporation, which, in accordance with section 534(c) of the 1954 Internal Revenue Code, submitted a statement to the respondent giving the grounds upon which it relied to establish that all or any part of its earnings and profits had not been permitted to ac-

cumulate beyond the reasonable need of its business. Section 534(a) of the 1954 Internal Revenue Code provides that the burden of proof on the allegation that all or any part of the earnings and profits of the petitioner had been permitted to accumulate beyond the reasonable needs of the business is on the respondent with respect to the grounds set forth in the petitioner's statement.

The corporation's statement listed the following grounds for each of the years here involved: (1) the earnings and profits were accumulated to provide for the very large and undetermined liabilities to the Government for renegotiation of war contracts, for income and excess profits taxes and for the operational needs of the business; (2) the earnings were needed for the contemplated expansion of the business into other fields, the acquisition of other companies and businesses and for the planned construction of factories in other countries; and (3) the earnings and profits were needed to provide against losses and costs of changing to different fields of manufacturing, to offset losses incident to termination of military contracts, to supply the funds to obtain the necessary plant and equipment for the manufacture of civilian items and to finance the development of a market for such items.

Respondent argues that the corporation's statement does not contain the required facts to support the listed grounds and that, consequently, such statement does not shift the burden of proof to respondent as to any of the grounds. It is not at all certain that the facts set forth by the corporation are sufficient to support the listed grounds. However, even if we assume that the burden

of proof has shifted to the respondent, we feel that he has successfully met this burden.

No dividends were declared by Good-All Electric Mfg. Co. during its fiscal years ended May 31, 1950 through 1954.[7] The corporation's records show that its earned surplus and undivided profits at the end of the fiscal years ended May 31, 1950 through 1954 were $323,366.13, $955,-421.46, $1,138,748.37, $1,581,729.06 and $2,528,642.29, respectively. During these years the Goodalls, through their partnership, were in complete control of the corporation. They continually withdrew corporate funds for their own or partnership purposes during these years. The corporation's records show that as of the end of the fiscal years ended May 31, 1950 through 1954 the outstanding balances of withdrawals (shown as amounts due from officers) were $203,043.48, $273,152.58, $309,696.15 and $880,273.20, and that by May 31, 1954 the outstanding balance of corporate withdrawals was about $1,660,000. The record shows that as of June 1954, at least $1,318,000 of the corporate withdrawals were used for the operations of the Goodall Oil Co., which was operated as a division of the partnership. It thus appears that the bulk of the corporation's earnings was used for purely personal expenditures or for other ventures of the Goodalls. Such continual use of the corporate funds strongly indicates, in our opinion, that its earnings and profits to this extent were not needed in the operation of the corporation's business and that such amounts were accumulated beyond its reasonable

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7 Good-All Electric Mfg. Co. on May 28, 1949 took over the operation of the business from the partnership of R. A. and C. M. Goodall.

needs within the meaning of the statute. *Helvering v. National Grocery Co.*, 304 U. S. 282.

We have examined the various grounds put forth by petitioner to justify the accumulation of its earnings and profits, and we are persuaded that none of them has any merit. As to the purported expansion plans, the record merely tells us that Robert made trips in 1953 to England and to Mexico to investigate the possibility of extending operations to those countries. These trips were merely exploratory. Petitioner makes no effort to show what portion of the earnings and profits was needed for this expansion or, for that matter, that the earnings and profits accumulated in prior fiscal years were insufficient. There are no corporate minutes, nor any other specific corporate records, to show that these plans were contemplated or their scope. Moreover, the record shows that these plans were dropped because of Robert's death in October 1953, some seven months before the end of the fiscal year 1954, which would certainly weaken any justification for accumulating the fiscal year 1954 earnings for such expansion purposes.

As to the purported need to retain earnings to meet potential renegotiation liabilities, the record shows that it was not until July 1952 that the corporation was informed by the Renegotiation Board that its fiscal year ending May 31, 1950 was to be renegotiated. (No renegotiation liability was ultimately determined for fiscal year ended May 31, 1950.) It was not until January 1954 that the corporation's fiscal year ended May 31, 1951 was before the Renegotiation Board and not until November

1954 (after the years here involved) that the corporation was notified of a tentative determination for the fiscal year ended May 31, 1951. (This finally involved a net repayment to the Government of $56,632.36). Nor does it appear that the corporate management was sufficiently concerned about these future liabilities to establish a reserve for this eventuality. As for the contention that there was a need to meet income and excess profits tax liabilities, it will suffice to say that the respondent did not begin his audit of these fiscal years, which are all before this Court, until about September, 1953 (during the last fiscal year here involved) and that the revenue agent's report was not completed until some years later. We are convinced that neither of these purported liabilities presented either an immediate need or a reasonably anticipated need of the business that prompted the retention of the corporate earnings and profits during these years.

There was no apparent need during these fiscal years to accumulate these earnings and profits for operational needs. The corporation's cash account, as indicated by financial statements in its returns, shows the amounts of $515,940.38, $685,997.36, $2,269,514.88, $1,619,636.41 and $3,198,585.98 as of May 31, 1950 through 1954, respectively. These steadily increasing inactive funds, when viewed against the background of constant withdrawals by the Goodalls, strongly indicate to us that the earnings and profits were not accumulated to meet the corporation's operational needs. Moreover, the favorable working capital position of the corporation, the nature of its current assets, and its sales pattern throughout these years sim-

ilarly negate the need for accumulating its earnings and profits for operational purposes.

Finally, we do not believe that the accumulation of the corporation's earnings and profits were prompted by the so-called hazardous nature of its business. No reserves were set up on the corporate books to meet this particular contingency and there is no real indication that management was concerned over this hazard during the years involved. The corporation's sales during these fiscal years rose from $1,185,689.54 in the fiscal year ended May 31, 1950, to $9,629,976.14 in the fiscal year ended May 31, 1954. The pattern of sales during this period was generally upward, and the record also shows that the corporation's sales exceeded $9,000,000 in each of the fiscal years ended May 31, 1955 and 1956, after the corporation had been sold. Certainly the healthy sales record does not leave room for any real concern over the purported hazardous nature of the business.

A careful examination of the whole record convinces us that the corporation's earnings and profits were permitted to accumulate during its fiscal years ended May 31, 1950 through 1954 beyond the reasonable needs of its business.

Under section 102 (c) of the 1939 Internal Revenue Code a finding that the earnings and profits of a corporation are permitted to accumulate beyond the reasonable needs of its business is deemed determinative of the purpose to avoid surtax upon its shareholders, within the meaning of section 102 (a) of the 1939 Internal Revenue Code, unless the corporation proves to the contrary by a

clear preponderance of the evidence. *Pelton Steel Casting Co. v. Commissioner,* 251 F. 2d 278, affirming 28 T. C. 153. We hold that the corporation has not met its burden of proof in this respect.

During the fiscal years here involved the Goodalls, through their partnership, were in complete control of the corporation and had ready access to the corporate funds. During each of the fiscal years during this period they withdrew large amounts from the corporation for their personal needs or to finance ventures which had nothing to do with the corporation. During this period of time the Goodalls were in the high income tax brackets. In their joint Federal income tax returns filed for the years 1950 through 1953 the Goodalls reported income in the respective amounts of $148,275.95, 59,382.42, $49,091.08 and $391,289.94. (Clarice filed a joint return for 1953, the year of Robert's death). The individual income tax return filed by Clarice for 1954 showed adjusted gross income of $541,987.63, while the fiduciary income tax return filed for 1954 by the estate showed taxable income of $186,028.20. No dividends were declared by the corporation during the fiscal years ended May 31, 1950 through 1954 and it is clear that this failure to pay dividends resulted in significant tax savings. It is also evident that by keeping the earnings and profits of the corporation undistributed the Goodalls were able to carry on their other ventures with corporate funds unreduced by the high personal income taxes. We hold, on the basis of the entire record, that Good-All Electric Mfg. Co. was availed of during each of the fiscal years ended May 31, 1950 through 1954 for the purpose of preventing tax upon its

shareholders within the meaning of section 102 of the 1939 Internal Revenue Code.

It is clear that in computing the "undistributed section 102 net income" the corporation is not entitled to a dividends-paid deduction under sections 27 (b) and 102 (d) (2) of the 1939 Internal Revenue Code. The actual tax under section 102 is imposed upon the "undistributed section 102 net income", which is defined in section 102 (d) (2) of the 1939 Code as "section 102 net income minus the basic surtax credit provided in section 27 (b)." Section 27 (b) of the 1939 Code defines "basic surtax credit" as the sum of the dividends paid during the year and certain other items. Section 27 (h), however, provides that "[t]he amount of any distribution * * * shall not be considered as dividends paid for the purpose of computing the basic surtax credit, unless such distribution is pro rata."

It has been stipulated that a portion of the salary paid by the corporation to Clarice in each of the fiscal years ended May 31, 1950 through 1954 should be disallowed as excessive. These disallowed amounts, however, remain as taxable income to Clarice. It is obvious that these amounts cannot be considered as pro rata distributions within the meaning of section 27 (h) of the 1939 Internal Revenue Code and therefore may not qualify as a dividends-paid deduction in computing the corporation's "undistributed section 102 net income."

Respondent also disallowed a portion of the deductions claimed by Good-All Electric Mfg. Co. in each of its fiscal years ended May 31, 1950 through 1954 for

rental payments it made to the partnership of R. A. and C. M. Goodall, with the explanation that the amounts disallowed were not ordinary and necessary business expenses. The rental payments disallowed in the statutory notice of deficiency were as follows:

Fiscal Year Ended May 31	Allowed	Disallowed
1950	$ 28,053.38	$ 31,774.03
1951	35,501.88	98,812.13
1952	44,962.93	263,644.37
1953	64,813.01	218,340.64
1954	99,053.62	382,226.43

These payments were made under the Manufacturing and Rental Agreement under which the corporation took over the operation of the electrical products manufacturing business which had been operated by the partnership. Robert Goodall had developed the electrical products, mostly capacitors, and the partnership owned the necessary machinery and equipment for the successful manufacture of such products. It may readily be inferred from the record that the partnership had developed beneficial sales contacts. (The corporation had sales of $1,185,689.54 in its first fiscal year). Important skills and "know-how" had been developed during the partnership's operation of the business. Thus when the newly activated corporation acquired the manufacturing business in May 1949 it acquired much more than the use of buildings, land, machinery and equipment. In fact, the Manufacturing and Rental Agreement recognizes this when, in fixing the payments to the partnership at 5 per cent of the corpora-

tion's gross sales, it calls attention to the fact that the production of the electrical products "depends largely upon the use of machines which have been perfected by the [partnership] and upon the knowledge of the partners and their employees" and then goes on to state that "this 5% hereinafter referred to as the commission is being paid for the use of the trade name, plant and equipment formerly used by the partnership in lieu of any royalties for the privilege of manufacturing such products and for the benefit of the industrial 'know-how' of the engineers and employees of the partnership."

The issue is a factual one. In *Roland P. Place,* 17 T. C. 199, affd. 199 F. 2d 373, this Court said that "[t]he basic question is not whether these sums claimed as a rental deduction were reasonable in amount but rather whether they were in fact rent instead of something else paid under the guise of rent. The inquiry is whether the petitioner was in fact and at law 'required' to pay these sums as rent." See also *Southern Ford Tractor Corporation,* 29 T. C. 833.

Respondent introduced evidence to show that a "reasonable rental" was below the rental payments actually made by the corporation. However, the shortcomings of respondent's evidence are readily apparent. Respondent's witness computed what he regarded as a sufficient rental to yield a reasonable return on the partnership's investment in its machinery, equipment, buildings and land which were used by the corporation. But, as indicated earlier, the Manufacturing and Rental Agreement covers much more than a mere rental of these fixed and real assets,

and we do not see how respondent can justifiably limit the scope of the agreement in this way.

Considering the benefits obtained by the corporation under the agreement, we do not feel that payments to the partnership set at 5 per cent of gross sales were at all unrealistic. The large payments to the partnership in the later years are of course a direct result of the dramatic increase in the corporation's sales. This, however, does not of itself affect the amount of the deduction to which the corporation is entitled. See *Stanley Imerman*, 7 T. C. 1030. We find, on the basis of the whole record, that the payments made by the corporation under the Manufacturing and Rental Agreement were in fact required rental or commission payments, and were not something else paid in the guise of rent. We hold that these payments are fully deductible as ordinary and necessary business expenses during the fiscal years ended May 31, 1950 through 1954.

The issues before us in Docket No. 95387, involving the income tax liability of the Estate of Robert A. Goodall for 1953, are the same as the issues involving that year in Docket No. 95388 (discussed below) and will therefore be controlled by our decision in that docket. The Estate of Robert A. Goodall (Docket No. 95387) will be entitled to a deduction under section 126(c), Internal Revenue Code of 1939, for an estate tax liability, as determined in Docket No. 72361. In Docket No. 95388, respondent determined income tax deficiencies as well as additions to tax against the Estate of Robert A. Goodall and Clarice M. Goodall for the years 1950 through 1953. Our decisions

with respect to these issues will be controlling in so far as these same issues also involve other years in the dockets before this Court.

During the years here involved Robert and/or Clarice continually withdrew large amounts from their corporation. Respondent here contends that such withdrawals were taxable as dividend distributions, while the petitioners in the relevant dockets argue that such withdrawals were loans. Whether these withdrawals represent loans or, instead, were advances for permanent use in the nature of dividends depends upon the existence at the time of the withdrawals of an intent on the part of the shareholder that it should be paid back and on the part of the corporation to enforce such payment. In *Elliott J. Roschuni*, 29 T. C. 1193, affirmed per curiam 271 F. 2d 267, this Court stated that "[w]hether withdrawals from a corporation represent loans or taxable distributions depends on all the facts and circumstances surrounding the transactions between the stockholders and the corporation" and that "[w]hen the withdrawers are in substantial control of the corporation, such control invites a special scrutiny of the situation."

It should be recognized at the outset that the dealings of the Goodalls (or their partnership) with the corporation were marked by great informality throughout most of the period here involved. In fact, it appears that during the first few years of the corporation's active life its operations continued to be recorded on the partnership books.

Respondent points out that no notes were ever exe-

cuted to cover these corporate withdrawals and that no interest was ever paid to the corporation on the outstanding balances. Respondent also calls our attention to the lax bookkeeping methods of the parties involved in keeping a record of the outstanding balances of the withdrawals from year to year. On the other hand, the record shows that the withdrawals were, from the beginning, treated by the corporation as amounts due from its officers, i. e., the Goodalls, and they so appear in the corporate balance sheets in the tax returns. There were substantial repayments throughout this entire period, and on June 2, 1954 (when the corporation was sold) Clarice repaid the corporation about $1,660,000 which represented nearly all the outstanding balance of withdrawals still owed to the corporation. The bookkeeper also testified that this check was "to pay what they owed the company."

We have examined all of the evidence, giving due consideration to the context of the facts before us, and we conclude that the corporate withdrawals were in fact intended as loans. We hold that such withdrawals over the period here involved were not taxable as dividend distributions.

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Decisions will be entered under Rule 50.